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UNCLAS SECTION 01 OF 02 TAIPEI 002741

SIPDIS

SENSITIVE

STATE PLEASE PASS AIT/W AND USTR

STATE FOR EAP/RSP/TC, EAP/EP AND EB/IFD/OIA

USTR FOR Audrey Winter and Tim Wineland

USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/ZELIKOW AND WISNER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A

TAGS: [EINV](#) [EFIN](#) [ECON](#) [PINR](#) [TW](#)

SUBJECT: TAIWAN DISCOURAGES EXCHANGE RATE SPECULATION

1. (U) Summary. Taiwan's Central Bank of China (CBC) is trying to discourage exchange rate speculation on the new Taiwan dollar (NTD) by administrative measures and a campaign suggesting that, based on economic fundamentals, the NTD should not appreciate against the US Dollar (USD). Some US\$8 billion may have come to Taiwan in anticipation that appreciation of the Renminbi could prompt the NTD to gain strength. Nevertheless, on June 23, the NTD gained NTD 3.5 cents to close at NTD 31.35/US\$1. End Summary.

Small Trade Surplus & Large Tourism Outflow

2. (U) Local newspapers reported June 23 that CBC suggests that the NTD should depreciate, rather than appreciate, against the USD. CBC distributed trade and selected balance of payments data to support its conclusion that the NTD should not be grouped with other (Asian) currencies likely to appreciate relative to the USD. The CBC distributed a statistical table comparing Taiwan's 2005 trade surplus with the trade surpluses recorded by four other major trading economies in East Asia. The table showed the following trade surpluses (in million US\$) for the first five months of 2005:

Taiwan	549
Japan	34,599
China	30,064
South Korea	10,323
Singapore	6,079

CBC officials also told the press that Taiwan residents' offshore travel spending in the first five months of 2005, estimated at US\$3,000 million, is much higher than the five-month trade surplus of US\$549 million.

Economic Fundamentals Don't Support Strong NTD

3. (SBU) Market participants tell AIT/T that the CBC is trying to make the case that economic fundamentals, in this case a small trade surplus and huge offshore travel spending, indicate that the NTD is not in such a strong position. In addition, Taiwan's foreign direct investment (FDI) account regularly posts a large deficit. (Note: Taiwan's FDI account in the balance of payments accounting has regularly posted large deficits for several years. Taiwan's overall services account in the Balance of Payments table for the first quarter of 2005 shows a net outflow of about USD 1 billion. End note.)

Speculative Money in Taiwan

4. (U) Despite CBC's description of the economic fundamentals, there has been upward pressure on the NTD. According to newspaper reports, the CBC has attempted to maintain a stable NTD exchange rate over the past several months even though foreign portfolio investors continue to post net stock purchases. According to trading records compiled by the Taiwan Stock Exchange, foreign portfolio investors' net stock purchases in the first 22 days of June 2005 totaled NT\$98.8 billion (or US\$3.1 billion at the exchange rate of NT\$31.3 per USD).

5. (SBU) AIT/T understands that Taiwan officials believe that a significant part of these foreign portfolio

investment inflows are speculative. Anticipating appreciation of China's Renminbi, which might prompt the NTD to gain strength, foreign investors have deposited "hot money" in interest-free checking accounts. Anticipated NTD appreciation would bring handsome profits that would more than cover an apparent interest-rate loss caused by parking funds in Taiwan checking accounts. Funds now in interest-free accounts in Taiwan could otherwise be earning 3% from bank deposits in the United States.

CBC Calls -----

16. (SBU) Estimates are that hot money in Taiwan is about NT\$170-180 billion (US\$5.4-5.7 billion at the exchange rate of NT\$31.3 per USD). This amount is down from previous estimates of NT\$260 billion (US\$8.3 billion). The CBC recently began expressing its "concern" over the accumulation of funds in interest-free accounts by contacting fund managers if funds remaining parked in bank accounts for more than a month. Despite such actions by the CBC, market participants say that investors continue to park large amounts in accounts and only use a small portion for trading in the stock market.

COMMENT -----

17. (SBU) The CBC clearly remains concerned about the quantity of what it views as speculative funds parked in Taiwan. It has stepped up its efforts to discourage speculative funds by administrative actions (phone calls to fund managers) and now a public campaign suggesting that, if anything, the NTD is overvalued rather than undervalued. However, the market, probably looking at the broader economic fundamentals, delivered its judgment by continuing to buy the NTD, pushing it up 3.5 NT cents to close June 23 at NT\$31.35 per USD. End Comment.

PAAL